

Factsheet 30 September 2023

NIKKO AM INCOME STRATEGY

Applies to the Nikko AM Income Fund

Market Overview

- The S&P/NZX 50 Gross (with imputation credits) Index fell 2.23% over September and declined 5.2% over the quarter ending September 2023.
- The bond sector as measured by the Bloomberg NZ Bond Composite Index also declined 1.42% and 1.62% for the quarter.
- Inflation is remaining stubbornly high and NZ, like many other nations are facing strongly rising energy and fuel prices which quickly spreads across the economy as transport and distribution operators pass on higher costs.

Fund Highlights

- The Income Fund fell over the past month and quarter as equity and bond markets both fell.
- Of the 14 companies in the equities portfolio only Heartland, Skellerup, Contact, Argosy and Infratil delivered positive returns over the quarter.
- Interest rate sensitive companies generally performed poorly as did the electricity sector. Short term bonds and cash outperformed longer-term bonds as bond market weakness was seen internationally and the increasing supply of NZ Government bonds put upward pressure on rates.

Distributions

- The defined distribution rate (which is used to calculate the distribution you receive from the fund) is set at the start of each calendar year, based on the price of the fund at that point. The defined distribution rate for 2023 is 5.5%. This income will be distributed in four equal amounts each calendar quarter, based on the price on 1 January 2023.

Performance ^{1,2,3}

	One month	Three months	One year	Three years (pa)	Five years (pa)	Ten years (pa)
Retail ¹	-0.18%	-0.26%	2.48%	-0.23%	0.15%	3.15%
Benchmark ²	0.67%	2.08%	7.76%	5.13%	5.34%	6.22%
Market Index ³	-1.08%	-1.74%	3.12%	-1.19%		

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).

2. Current benchmark: RBNZ Official Cash Rate +3.00% p.a.

3. Current appropriate market index: 62.5% Bloomberg NZBond Credit 0+ Yr Index, 30% S&P/NZX 50 Gross Index, 7.5% Alternatives exempt.

Five Year Cumulative Performance, \$10,000 invested^{1,2}



Portfolio Manager

Fergus McDonald,
Head of Bonds and Currency



Fergus is responsible for the investment of the Bond, Cash and Currency mandates. Fergus has been actively involved in the NZ financial markets since 1981. The portfolio management team for the domestic fixed income funds includes Ian Bellew, Senior Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

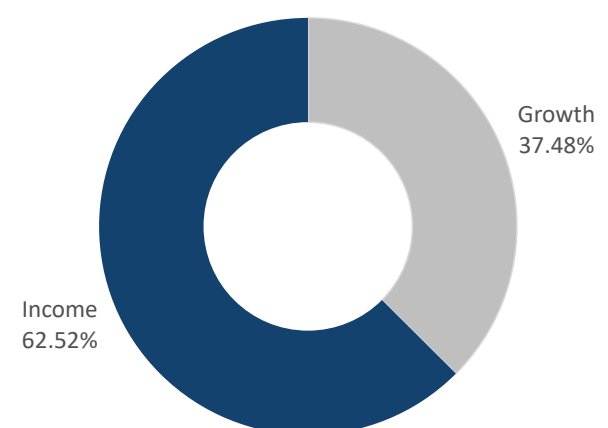
Overview

The strategy aims to provide investors with regular income from an actively managed investment portfolio. The fund invests in NZ fixed interest, Australasian equities and property. Equities with a good dividend stream and a focus on growing value over time are selected as an attractive alternative to fixed income securities. Equity selection is determined by the NZ investment team.

Objective

The objective of this fund is to outperform the RBNZ Official Cash Rate by 3.00% p.a. over a rolling three-year period before fees, expenses and taxes. Prior to June 2020, the objective and strategic asset allocation of fund were materially different. From 1 July 2020 these were amended to include equities.

Asset Allocation



NIKKO AM NZ INCOME FUND

Top 5 Fixed Income Issuers*	(%)	Duration*	Top 10 Equities	(%)	(%)
Westpac New Zealand	19.56	Fund 3.50 years	Bank Of New Zealand	3.21	Spark New Zealand 2.94
Kiwibank	5.11	Yield to Maturity	Works Finance NZ	3.14	Contact Energy 2.94
Powerco	4.65	Fund (gross) 6.59%	Heartland Group	3.09	Meridian Energy 2.52
TR Group	4.21		Chorus	3.00	Skellerup 2.49
Kiwi Property Group	3.85		Infratil	2.98	Kiwibank 2.04

*Includes cash holdings.

Fund Commentary

The Income Fund fell over the past month and quarter as equity and bond markets both fell. The S&P/NZX 50 Gross (with imputation credits) Index fell 2.23% over September and declined 5.2% over the quarter ending September 2023. The bond sector as measured by the Bloomberg NZ Bond Composite Index also declined 1.42% and 1.62% for the quarter.

Interest rates on longer term bonds continue to move higher globally and especially in the influential US Treasury bond market. Recent US economic data indicates the manufacturing sector is hiring again and various activity indicators are also improving. Inflation is remaining stubbornly high and NZ, like many other nations are facing strongly rising energy and fuel prices which quickly spreads across the economy as transport and distribution operators pass on higher costs.

The Reserve Bank will be looking with increasing concern at these developments and if inflation starts to rise again rather than fall then the "higher for longer" interest rate outlook will stop rates falling as quickly as hoped. A further increase in the Official Cash Rate is possible when the RBNZ meet in November and the market is currently pricing in such an outcome.

The Reserve Bank's latest Monetary Policy Statement indicated they will hold the cash rate at an elevated level of 5.5% until the end of 2024 as they monitor incoming economic data. They hope they have done enough to cool consumer demand, inflationary pressures and inflation expectations and further rate rises will not be required. It now seems the RBNZ is looking for reasons not to push cash rates higher however if inflation does not cool quickly enough and the labour market remains strong the RBNZ will not hesitate to react. This uncertainty about whether the OCR remains on pause or is increased is weighing on the minds of investors in both bond and equity markets.

Locking into longer term bonds around current levels will likely outperform cash returns over the next few years. We continue to believe the next significant move in rates is down but we might have to wait for a year or so until this occurs in any meaningful way and further modest rises could occur in the meantime. An OCR cash rate of around 3.5% to 4% is probable by mid-2026.

The fund owns 14 companies in its equities portfolio with Heartland, Skellerup, Contact, Argosy and Infratil all posting positive returns over the quarter. Interest rate sensitive companies generally performed poorly as did the electricity sector. Short term bonds and cash outperformed longer-term bonds as bond market weakness was seen internationally and the increasing supply of NZ Government bonds put upward pressure on rates. As has been the case for some time, short term bonds and cash have held their value as longer-term bonds and equities have suffered falling values. The Income Fund was holding close to 7.5% of the portfolio in cash at the end of September, this higher cash weighting helped to stabilise investment returns however in hindsight an even higher weighting would have been desirable.

We continue to believe investors should seek income from a diverse range of sources. Bond rates are looking attractive and even though some equity prices have fallen over the past year we believe the environment remains acceptable for many companies. The Income Fund remains invested in a range of NZ companies listed on the NZX that pay a consistent level of dividends or who have the likelihood of doing so in the future. In addition to dividend income, we expect over time the industry sectors and business models adopted by these companies should be rewarded by a steady or rising share price.

Key Fund Facts

Distributions	Estimated annual fund charges (incl. GST)
Distributions for this fund are defined annually and are effective for the calendar year. The defined rate is gross of tax. Distributions are not a taxable event. Tax will be deducted (refunded) at 31 March and on full or partial withdrawals.	0.80%, refer PDS for more details
Hedging	Buy /Sell Strategy size
All investments will be in New Zealand dollars	spread: \$3.2m
Exclusions: Controversial weapons.	Click to view
Restrictions: Adult entertainment, gambling, fossil fuels, alcohol stocks, tobacco stocks. For more information please refer to the Statement of Investment Policy and Objectives (SIPO) which can be found on our website https://www.nikkoam.co.nz/invest/retail .	Strategy Launch
	October 2007

Compliance

The fund complied with its investment mandate and trust deed during the quarter.

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